STATE OF CALIFORNIA PETE WILSON, *Governor*

PUBLIC UTILITIES COMMISSION
550 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

DOCKET FILE COPY ORIGINAL

February 1, 1995

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20036

Re: PR Docket No. 94-105

Dear Mr. Caton:

In accordance with the Order of the Federal Communications Commission ("FCC"), released January 25, 1995 and referenced as DA 95-111 in the above-captioned docket, as thereafter modified to permit additional time within which the California Public Utilities Commission ("California") could comply, please find enclosed for filing the following:

1. An original plus eleven copies of a revised, redacted version of California's petition and accompanying appendices in the above-referenced docket.

2. In a physically separate envelope marked "Confidential and Proprietary," an original and one copy of a revised, unredacted version of California's petition and accompanying appendices in the above-referenced docket. Included within this envelope is an original and one copy of an affidavit by Ellen S. LeVine attesting to how California obtained source materials, appended to the affidavit, which underlie information contained in the unredacted version of California's petition.

3. An original and eleven copies of a Request for Proprietary Treatment of Documents Used In Connection With Petition To Retain Regulatory Oversight of Cellular Service Rates in California.

If you have any questions, please call the undersigned at (415) 703-2047.

Very truly yours,

Ellen S. LeVine
Attorney for CPUC

Enclosures

No. of Copies rec'd 0+8
List A B C D E

ORIGINAL

Redacted Version

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

PR 94-105

In the Matter of	
Implementation of Sections 3(n) and 332 of the Communications Act	GN Docket No. 93-252
Regulatory Treatment of Mobile Services	

PETITION OF THE PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA TO RETAIN STATE REGULATORY AUTHORITY OVER CELLULAR SERVICE RATES

August 8, 1994
Revised February 1, 1995
per FCC Order of January 25, 1995

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SUMMARY

By this petition, the California Public Utilities Commission ("CPUC") seeks to retain its existing regulatory authority on an interim basis over the rates for cellular service within California, including the unbundled rate elements of cellular service, until effective competitive alternatives to such service emerge.

Based on the CPUC's analysis of evidence presented in the record of its investigation into the wireless industry in California, evidence gathered in response to data requests, and evidence cited in publications, the CPUC concludes that cellular service in California is not currently competitive, and that market forces are not yet adequate to protect California customers from paying unjust and unreasonable rates for such service. In reaching this conclusion, the CPUC evaluated the cumulative impact of various criteria, including: (1) structural barriers to competitive entry; (2) the market power of the duopoly cellular carriers, as measured by market share, degree of price competition, and level of earnings; and (3) the current availability of emerging competitive alternatives to cellular service.

It bears emphasis that no one factor, standing alone, is sufficient to demonstrate lack of competition in intrastate cellular markets. However, in combination, these factors make a compelling case that such markets are not currently competitive and that market forces are not yet adequate to ensure just and reasonable cellular rates to California business, industry, and residents.

Among other things, the CPUC found:

- The government-created duopoly structure for cellular service has created near absolute barriers to entry which, together with interlocking ownership interests between cellular carriers within and among markets in California, have permitted the duopolists in each market to price their services at non-competitive levels and to earn returns far above competitive levels. In the near term, competitive pressure from alternate providers of cellular service will not be sufficient to check prices and earnings of the duopoly cellular carriers;

- The market share between the duopolist cellular carriers in the same markets in California has remained substantially the same over a five year period, and, relative to cellular resellers, has steadily increased at the latters' expense;

- Cellular rates in California are among the highest in the nation, and have failed to decline commensurate with substantial declines in capital and operating costs of providing cellular service;

- The market value of cellular spectrum reflects investor expectations of earnings well above levels normally found in competitive markets, and are not commensurate with the capital investment made to expand capacity of cellular systems or otherwise explained by spectrum scarcity value.

Based on these and other findings, the CPUC believes that it has sustained its burden of demonstrating that continued regulatory oversight of cellular service rates in California is necessary until new market entrants -- principally providers of personal communications services and enhanced mobile radio services -- are effectively competitive to ensure just and reasonable rates to California consumers. Our findings are consistent with the U.S. Department of Justice's conclusion that cellular markets are not competitive.

The CPUC seeks to retain its regulatory oversight of cellular rates for 18 months, commencing September 1, 1994, after which time the CPUC expects that market forces, triggered by the widespread deployment and availability of

alternative competitive providers in California, will ensure just and reasonable rates to California consumers for cellular service.

During the transition to competition, the CPUC seeks to retain its existing price cap regulation of cellular rates. Moreover, in order to stimulate additional competition from cellular resellers prior to the entry of alternative providers of cellular service, the CPUC ordered the unbundling of competitive services currently bundled in the wholesale rates of the duopoly carriers. Such unbundling will allow switch-based resellers the option of purchasing competitive services from another provider, obtaining savings in the cost of providing service, and offering value-added services to California consumers. Retention of state authority over the rates charged by cellular carriers for the unbundled bottleneck services, at least on an interim basis, is essential in order to ensure that the pricing of such services does not effectively eliminate the cost savings which would otherwise be achievable by switch-based resellers.

The approach adopted by the CPUC is narrowly-tailored to the circumstances presently existing in California markets, and effectively addresses the transitional problems which California currently faces in moving to a fully and vigorously competitive wireless telecommunications industry. Accordingly, the CPUC respectfully petitions the Federal Communications Commission for authority to continue, for an interim period, its regulatory oversight of cellular rates.

PETITION OF THE PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA TO RETAIN STATE REGULATORY AUTHORITY OVER CELLULAR SERVICE RATES

The People of the State of California and the Public Utilities Commission of the State of California ("CPUC") hereby submit this petition to retain state regulatory authority over the rates for intrastate cellular service within California. This petition is submitted pursuant to Section 332(c)(3)(B) of the Omnibus Reconciliation Budget Act of 1993 ("Budget Act") and Second Report and Order, released March 7, 1994 by the Federal Communications Commission ("FCC") in the above referenced docket. By this petition, the CPUC demonstrates that it has met the statutory standard for the continued exercise of state regulatory authority over cellular rates. The CPUC therefore respectfully requests that the FCC grant this petition.

The CPUC is an administrative agency established under the constitution and laws of the state of California. Among its duties, the CPUC exercises general regulatory jurisdiction over public utility telephone corporations including cellular carriers operating within California. The CPUC also has a statutory mandate to represent the interests of consumers of telephone services, including cellular services, within the state of California before the FCC.

Pursuant to Section 332(c) of the Budget Act and the FCC's Second Report and Order, the CPUC is the agency duly authorized to file the instant petition. Appendices to this petition are being filed concurrently in a separate volume. Appendix A contains the CPUC's certificate.

I. BACKGROUND

Cellular services are public utility services as defined in § 234 the California Public Utilities Code. Public utility services are similar in definition to common carrier services under the Communications Act of 1934, 47 U.S.C. § 201, in that they must be offered indiscriminately to all upon reasonable request, and must be offered on terms and conditions that are just, reasonable and nondiscriminatory.

Since 1984, the CPUC has exercised authority over cellular service providers within California. Because of the absence of effective competition in the markets for intrastate cellular services, the CPUC specifically has exercised regulatory oversight of the rates, practices and other terms and conditions of such services in order to ensure that they remain just, reasonable and nondiscriminatory to the consumers of these services. At the same time, the CPUC has taken regulatory steps to encourage emerging alternative providers to compete for these services, with the ultimate goal of relying on market forces, rather than regulation, in ensuring the continuance of just, reasonable and nondiscriminatory practices and rates for cellular service for California businesses, industry, and residents.[1]

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[1] In November 1993, the CPUC outlined for the Governor its vision of California's telecommunications industry. In Report To The Governor: Enhancing California's Competitive Strength: A Strategy For Telecommunications Infrastructure ("CPUC's Infrastructure Report"), the CPUC stated that it will focus state regulatory oversight of telecommunications service providers on two principal objectives:

- Protect [subscribers] against unreasonable prices on access to the networks by firms that continue to dominate local telecommunications

The CPUC has a legitimate interest in protecting the interests of telecommunications consumers in California. Towards this end, the CPUC agrees with the FCC's view that where markets for commercial mobile radio service ("CMRS") are effectively competitive, competition is "a strong protector of these interests." (Second Report and Order, para. 23). Conversely, however, where CMRS markets are not effectively competitive, and such services are provided intrastate, the state regulatory agency is in a better position to ensure that the interests of its local consumers are adequately protected.

As this petition will demonstrate, in California competitive forces are not yet sufficiently developed to ensure that the rates charged by facilities-based cellular providers are just, reasonable and nondiscriminatory. The CPUC therefore has the duty and responsibility to protect California consumers from paying unjust and unreasonable rates for these services by asserting the minimum degree of regulation necessary until effective competition emerges to fulfill that duty. The

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markets; and

- Protect [subscribers] against the potential for fraud and similar abusive practices that accompany a highly competitive market.

The CPUC also notes that "firms who do not enjoy market power should be free from traditional entry and price regulation. Where healthy competition exists, no significant purpose is served by continued government intervention." (CPUC's Infrastructure Report, p. 14.)

As its objectives indicate, the CPUC does not intend to regulate a competitive market. However, the CPUC will and should protect subscribers' interests in the cellular telecommunications market as long as effective competition in that market has not emerged.

CPUC also has undertaken the responsibility for ensuring that a competitive market develops by preventing the dominant facilities-based cellular carriers from competing unfairly against cellular resellers and new market entrants.

A. Omnibus Reconciliation Budget Act of 1993

The 1993 federal Budget Act defined a federal regulatory framework governing CMRS. Commercial mobile services are common carrier services, and include cellular services.

Among other things, Congress enacted Section 332(c)(3) which generally preempts states from regulating the entry or rates charged by any commercial mobile service. Congress, however, made clear that it did not "prohibit a State from regulating the other terms and conditions of commercial mobile services." In addition, Congress specified that with respect to a subcategory of commercial mobile services that are a substitute for land line telephone exchange service for a substantial portion of the communications within such state, states could impose requirements on such providers when similar requirements apply to other telecommunication service providers for the purpose of "ensur[ing] the universal availability of telecommunications service at affordable rates."

Moreover, Section 332(c)(3)(B) provides that, notwithstanding the preemptive language of this section,

> If a state has in effect on June 1, 1993, any regulation concerning the rates for any commercial mobile service offered in such State on such date, such State may, no later than 1 year after the date of enactment of the

> Omnibus Budget Reconciliation Act of 1993, petition the Commission requesting that the State be authorized to continue exercising authority over such rates.

The FCC must grant the state's petition "to regulate the rates for any commercial mobile service" if the state demonstrates either that:

> (A)(i) "market conditions with respect to such services fail to protect subscribers adequately from unjust and unreasonable rates or rates that are unjustly or unreasonably discriminatory" or
>
> (A)(ii) "such market conditions exist and such service is a replacement for land line telephone exchange service for a substantial portion of the telephone land line exchange service within such State."

By this petition, the CPUC will demonstrate that it has met the standard set forth by Congress for continued state regulatory oversight of cellular service rates in California markets until effective competition from new market entrants is achieved.

Specifically, the CPUC will show with substantial evidence that continued regulatory oversight of cellular rates is necessary under Section 332(c)(3)(A)(i) because at this time the market forces are not adequate to protect California consumers from paying unjust and unreasonable rates for cellular service. The CPUC, however, emphasizes that its continued regulation is merely a transitional, and hence temporary, measure until effective competition for cellular services develops. The CPUC will continue its regulation for 18 months, starting from September 1, 1994.

B. Overview Of Petition

In reaching its conclusion that the market for cellular services is not yet effectively competitive in California, the CPUC evaluated the cumulative impact of various criteria, including:

- **Structural barriers to entry** at the wholesale level;
- **Market concentration** of wholesale cellular carriers that indicates what portion of the market each cellular carrier controls, based on the Herfindahl/Hirshman Index and definitions given by the Department of Justice's Guidelines for Mergers and Acquisitions;
- **Degree of price competition** between wholesale cellular carriers in each market and for individual carriers over time. These data show whether price competition exists between the carriers and how each carrier's prices varied over a period of time;
- **Earnings** of wholesale carriers. These data, measured in rate of return and operating margins, are indicative of market power when combined with other factors; and
- The current **availability of emerging competitive alternatives** to cellular service. New competitive entrants are personal communication services and enhanced specialized mobile radio services.

The CPUC gathered evidence for each of these criteria, some of which was submitted to the CPUC in a formal proceeding, allowing all interested parties an opportunity to participate.

It bears emphasis that no one factor standing alone conclusively determines the degree of competitiveness, nor is there industry-wide agreement on an exact measure of competitiveness. However, in combination, the data with respect to each of these indirect measures of competition make a compelling case that the cellular market in California lacks effective competition and that market forces are

not yet adequate to ensure rates that are just and reasonable to California consumers without continued regulatory oversight.

Specifically, with respect to cellular services, the CPUC has found that:

(1) The government-created duopoly structure for cellular service has created near absolute barriers to entry which, together with interlocking ownership interests between cellular carriers within and interlocking ownership interests between cellular carriers within and among markets in California, have permitted the duopolists in each market to price their services at non-competitive levels and to earn returns above competitive levels;

(2) At present, competitive pressure from alternate providers of cellular service is not yet sufficient to check prices and earnings of the duopoly cellular providers. Accordingly, in the near term, until Personal Communications Service ("PCS") and Enhanced Specialized Mobile Radio ("ESMR") services become sufficiently developed, cellular services will not be effectively competitive;

(3) Prices of wholesale cellular carriers in California are among the highest in the nation, and have remained high despite declining capital and operating costs. The rates between the duopoly providers of cellular services in specific geographic markets have remained strikingly similar and have not significantly declined over a period of ten years despite lowered capital and operating costs; and

(4) Earnings of the duopoly providers of cellular services are well above levels normally found in competitive markets, and cannot be explained completely by spectrum scarcity value.

The CPUC submits that it is in the public interest of California consumers for the CPUC to retain its ongoing management of the transition toward effective competition by continuing to exercise authority over the cellular industry. The CPUC therefore seeks to continue its regulatory oversight for 18 months, commencing September 1, 1994, during which time the CPUC expects to see effective competition from new entrants into California cellular markets.

In managing the transition to competition, it bears emphasis that the CPUC

has significantly reduced its level of regulatory oversight of the rates charged by cellular carriers. Currently, cellular carriers are given substantial flexibility to raise and lower rates to respond to market conditions in a manner which protects consumers of these services. The CPUC continues to take steps to foster competition for cellular services. Recently, as discussed below, the CPUC adopted a proposal to unbundle market-based access charges from cellular wholesale rates to stimulate additional competition from switch-based cellular resellers.

II. WIRELESS REGULATORY FRAMEWORKS AND CELLULAR DUOPOLY STRUCTURE

This section discusses the historical context of the CPUC's regulation of rates and entry for both radiotelephone utilities ("RTUs") and cellular companies. It also discusses current proposals before the CPUC for maximizing competition and easing regulation in the cellular industry during the transition to competition.

A. CPUC Rate Regulation for Wireless Utilities

1. Wireless Regulatory Policy

The FCC has established a total of 30 designated areas in California for the provision of cellular service. These areas consist of 18 metropolitan statistical areas ("MSAs") and 12 rural statistical areas ("RSAs"). Two licenses -- one for the local telephone company (wireline carrier - Block A) and a second for the non-wireline carrier (Block B) -- were issued in each statistical area, creating from the

inception of cellular a duopoly (two-firm) market structure. The FCC allocated 20 MegaHertz ("MHz") of frequency to each carrier. A second allocation of 10 MHz took place in 1986, which gave an additional 5 MHz to the each carrier.

The CPUC's regulatory policies on wireless telecommunication utilities have reflected the basic philosophical direction, also embraced by the FCC, of relying on competitive forces to set prices and promote the most rapid expansion of service and technology. Toward this end, regulatory measures have been adopted to encourage competition and innovation, remove barriers to the introduction of new services, and minimize requirements governing telecommunications products, services and related applications. However, regulatory measures have also been adopted to protect against the potential harmful effects of non-competitive wireless utility practices. As competition has developed, these rules have been relaxed.

The ultimate goal of the CPUC's regulatory policies is to ensure that effective competition develops in the wireless market as quickly as possible. During the transition to effective competition, the CPUC remains committed to its statutory charge of protecting consumers from unjust and unreasonable rates and other terms and conditions, and protecting new wireless entrants from unfair competition from carriers with market power.

The CPUC has two existing wireless regulatory frameworks in place today. One regulatory framework is for the RTU industry and the other is for the cellular industry. The different regulatory frameworks reflect the difference in levels of

competitiveness of the two wireless industries. The CPUC has found the RTU industry to be competitive and has adopted a regulatory framework within existing California law that gives the industry maximum regulatory flexibility. Although the CPUC has adopted similar rate flexibility for the cellular industry in the hope of fostering competition and lowering rates, the duopoly structure, unique to that industry, and the duopolists' significant market power have greatly limited competition. Accordingly, the CPUC believes that regulation of cellular carriers should continue for at least 18 months, commencing September 1, 1994, during which time the CPUC expects that new competitive entrants will allow market forces to substitute for regulation in ensuring just and reasonable rates for cellular service.

The CPUC has also opened up two formal proceedings that will affect the wireless industry. The first is an investigation into Mobile Telephone Service and Wireless Communications that will modify existing regulatory frameworks based on whether the carrier is determined to be dominant or non-dominant. The second proceeding is a rulemaking to establish a simplified registration process for non-dominant telecommunications firms.

2. Existing RTU Regulatory Framework

Two decisions (D.92-01-016 and D.93-01-045) in the CPUC's rulemaking into the regulation of radiotelephone utilities (R. 88-02-015) established the existing RTU regulatory framework. In those decisions the CPUC found that,

except for some remote rural areas, the RTU industry was effectively competitive. There are 92 RTUs with certificates of public convenience and necessity in California.

In remote rural areas, approximately 223 subscribers (e.g., U.S. Forest Service and California Highway Patrol) use two-way mobile services as a substitute for wireline basic service. This is because wireline basic service is economically prohibitive and cellular or other alternatives are not presently available. Expansion of cellular service and growth in Basic Exchange Telecommunications Radio Service are reducing the number of customers using two-way mobile service for basic service by about 3.5 percent per year.

The existing RTU regulatory framework allows RTUs to lower rates to any level on one day notice. Minor rate increases (i.e., rates that don't exceed five percent of current rates or 1 percent of gross revenue) can be filed on five days notice without CPUC approval. RTUs can also raise rates by any amount on 30 days notice under the same procedure. For large rate increases,[2] however, the CPUC may adjust rates if it is found that protests of rate increases have merit (e.g., 50 percent rate increase where there is only one telecommunications service provider). Rates are market-based, not cost-based (i.e., carriers do not have to provide any cost data to the CPUC to justify rates).

[2] Major rate increases are those that exceed 5 percent of current rates or 1 percent of gross revenues.

3. Existing Cellular Regulatory Framework

In 1984, the CPUC issued its first decision on cellular regulation. By D.84-04-014, the CPUC granted state certification to Los Angeles SMSA (a wireline carrier) to provide service in the Los Angeles market. In that decision, the CPUC established two major policies that remain in effect today: (1) the adoption of market-based, not cost-based, rates for cellular services, and (2) fostering competition for cellular service at the retail level. The first policy allowed the cellular industry to set retail rates for any service plan based on what the market would bear and not on cost. Minor rate increases could be filed by advice letters and major increases by application in accordance with the requirements of the CPUC's General Order 96-A on tariffs.

The second major policy in D.84-04-014 was to establish a viable resale plan to foster competition and mitigate any adverse effects of the early entry into the cellular marketplace of a wireline carrier in advance of a nonwireline carrier. Accordingly, the CPUC established a margin between wholesale and retail rates for resellers. The margin was based on a year one pretax profit margin of 8.3 percent for a hypothetical reseller with 60 percent of the market. Additionally, due to the resale plan for aggressive growth, California today has the largest number of cellular subscribers in the U.S.

After several years of experience with cellular service, the CPUC opened Investigation (I.) 88-11-040 to examine whether the regulatory structure established in 1984 was meeting CPUC objectives and if changes in the structure

were warranted. Following Phases I and II of that investigation, the CPUC issued D.90-06-025. The CPUC's intent in D.90-06-025 was to promote competition for cellular service. Yet, the CPUC expressed concern that competition within the cellular market still was constrained by the limitations on market entry imposed by the FCC duopoly licensing rules. As noted therein: "Were it our choice, we would license additional carriers to assure the public the full benefits of a well-working competitive industry without a need for substantial regulatory intervention." (D.90-06-05, slip op. at p. 5) Because the CPUC lacked authority to license additional carriers, however, the CPUC maintained a degree of regulatory oversight of cellular carriers while seeking alternative ways to enhance competition within the cellular market.

Specifically, in D.90-06-025, the CPUC elected to monitor pricing and investment behavior of duopolists for the purpose of detecting any "failure to compete" at the wholesale level. The CPUC elected this approach in 1990 on the grounds that cellular service was "discretionary" and complemented wireline telephone service, and that rapid technological changes made industry oversight difficult and traditional cost-of-service regulation problematic. Nonetheless, the CPUC did not relieve cellular carriers seeking to increase rates from providing some measure of cost support justifying higher rates. See Ordering Paragraph 9 of D.90-06-025, slip op. at p. 109.[3]

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[3] In a dissent to D.90-06-025, Commissioner Duda stated that duopoly theory tells us that both firms will tend to keep prices above the competitive level and compete on service, since reducing profits would result in losses to both

In response to requests from facility-based cellular carriers, the CPUC in D.90-06-025 authorized temporary tariff rules to enhance the effectiveness of competition between carriers by making regulatory policies more flexible. Under temporary tariff authority cellular utilities could file temporary tariffs or promotions with an expiration date that lowered rates by up to 10 percent of the carrier's average bill. The temporary tariff rates would become effective immediately upon filing. Absent a protest within the twenty day protest period after the filing, the temporary tariff would become a permanent tariff. Multiple temporary tariffs could be filed during a year, allowing the utility to lower rates to any level it chose.

D.90-06-025 also authorized the facilities-based carriers to file bulk rate tariffs for large organizations. Bulk-user retail rates had to be priced at least 5 percent above wholesale rates in order to compensate for some of the costs resellers incur that bulk-user organizations do not.

Based on the evidence presented, the CPUC believed that it would take approximately five years for cellular service to reach a penetration of 5 percent (i.e., mid 1995, although penetration rates actually exceeded that in less than two years). The penetration rate is the number of cellular phones divided by the total

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companies. He pointed out that in the record, the returns on wholesale investment for 1988 ranged between a low of 25.1 percent to a high of 123.1 percent earned in the major markets (Los Angeles, San Francisco/San Jose and San Diego). The weighted average rate of return on net book plant for carriers operating at least three years exceeded 45 percent. This information clearly demonstrated the duopoly theory, according to Commissioner Duda.

population base.[4] The CPUC also concluded that enhanced services need not be tariffed.

The CPUC next modified the Uniform System of Accounts for cellular service in D.90-06-025 to include cost allocation methods for wholesale and retail operations of facilities-based carriers. The CPUC ordered the removal of fixed margins for the resellers, with the implementation of the new accounting system to be addressed in a subsequent phase of the proceeding. The accounting system would allow the CPUC to monitor the industry to see that the facilities-based carriers were not subsidizing their retail outlets (retail outlets had to at least break even), a practice of some carriers, as evidenced in annual reports filed with the CPUC. Given the variance in cost allocation between carriers, the CPUC found it necessary to establish a specific set of guidelines. The CPUC also put into a subsequent phase of the proceeding a proposal to allow the resellers to build a switch to introduce more competition at the wholesale level.

In October 1992, the CPUC addressed the remaining issues in its investigation into the cellular framework (Phase III decision, D.92-10-026). The CPUC adopted a new uniform system of accounts, which standardized the cost allocation methods used by the facilities-based carriers to apportion costs between their wholesale and retail operations.

In the same decision, the CPUC also adopted a proposal for a reseller switch

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[4] This calculation differs from that used for landline service, where penetration rates are normally determined based on the number of households instead of the total population.

to substantially increase competition at the wholesale level. In addition, some of the new services proposed by the resellers were not being offered by the facilities-based carriers. In the adopted proposal a reseller would be allowed to build a switch, purchase blocks of numbers from the local exchange company, and interconnect with the interexchange companies', local exchange companies', and facilities-based carriers' switches. When the facilities-based carrier switch received a call with a reseller number, the switch would automatically route the call to the reseller switch to process the call and provide enhanced and other services. To effectuate competition, the reseller switch proposal would require unbundling of the wholesale rates. The bottleneck portion of the facilities-based carriers' facilities (i.e., the cell sites, trunks to the switch, and certain switch functions) would be cost-based with a rate of return; the remaining components of the wholesale rate would be market priced.

Decision 93-05-069 granted the facilities-based carriers a rehearing on the October 1992 decision on the accounting cost standards for allocation of costs between wholesale and retail and the reseller switch proposal. The facilities-based carriers claimed this proposal was inconsistent with the June 1990 Phase II decision. They alleged that unbundling of wholesale rates and cost-based pricing of bottleneck functions were tantamount to cost-of-service regulation, which the CPUC said would not be used for setting rates for the cellular industry. They also asserted that there were no bottleneck functions because there were two cellular companies with separate facilities in each market. The duopolists also protested

the costing method of using embedded cost in lieu of incremental cost. The CPUC, however, had given the carriers the option of submitting incremental cost studies, if the industry could agree on a definition of cost. The issues were subsequently consolidated with I. 93-12-007, the investigation into mobile telephone service and wireless communications, discussed below.

In April 1993, the CPUC addressed claims from the facilities-based carriers that cellular rates had not fallen because the carriers did not have the ability to raise rates without CPUC authorization. The CPUC stated in its decision (D. 93-04-058):

> Three years later virtually none of the Commission's expectations [of reducing cellular rates] have been met by industry performance. While many urge that the fatal flaw is the expectation that duopolists will engage in meaningful competition, the industry has a different explanation as to why cellular rates in all segments of the California market have remained at their historic high levels. It is all the Commission's fault! The flexible pricing scheme which permitted carriers to reduce rates up to 10% on one days notice but required a substantiation for rate increases in an advice letter filing has "chilled" the carriers' desire to lower prices. Why? Because of a fear that once a price lowered, the Commission would obstruct a movement back to the old level.

D.93-04-058 established "rate band guidelines" to allow the industry to raise rates up to a maximum ceiling rate or lower rates by any amount on one day notice without Commission approval, as long as the margin between wholesale and retail rates was maintained. The existing tariffed rates would serve as ceiling rates. New optional service plans could be filed with any rates the utility wanted,

and these rates would serve as the ceiling rates when the tariff became effective.

As noted in the comments in I.93-12-007, none of the new or existing plans experienced any permanently lowered wholesale or retail rates under the rate band guidelines. Instead, the rate band guidelines were used to offer short-term promotional plans, some as short as one day, or to lower rates only slightly for optional long term plans. The long term plans were contracts which were automatically renewable each year, with stiff penalties for early termination. The penalties were not prorated, but remained the same whether the customer withdrew on the first or last day, and remained in effect when the contract was automatically renewed. The facilities-based carriers in many cases allowed customers to sign up orally, but the customer had to terminate in writing in a short time frame or be automatically renewed by default. Large commissions were paid to agents to enroll new customers on the automatically renewable contract plans.

In April 1994, the CPUC issued D. 94-04-043, which further relaxed and simplified the rate regulatory requirements for cellular carriers. By that decision, the CPUC removed the ten percent maximum reduction for temporary tariffs so the rates could be dropped to any level on one day notice. The decision also allowed the utilities to provide provisional tariffs (new service plans with termination dates) and withdraw optional plans without CPUC approval, assuming proper customer notice requirements were fulfilled. In addition, the decision allowed automatically renewable contract services to remain, providing certain changes were made to the tariffs. These changes included proration of termination penalties over the life of